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RR RUEHBC RUEHDE RUEHIHL RUEHMOS
DE RUEHKUK #0051/01 0611916
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R 021916Z MAR 06
FM REO KIRKUK
TO RUEHGB/AMEMBASSY BAGHDAD 0508
RUEHC/SECSTATE WASHDC 0545
INFO RUCNRAQ/IRAQ COLLECTIVE
RUEHKUK/REO KIRKUK 0572

C O N F I D E N T I A L SECTION 01 OF 02 KIRKUK 000051

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BAGHDAD FOR ECON, POL, NCT, USCOE, IRMO

E.O. 12958: DECL: 3/2/2016

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SUBJECT: KURDISH ECONOMY: OIL, IRAN AND CUSTOMS

KIRKUK 00000051 001.2 OF 002

CLASSIFIED BY: Scott Dean, Regional Coordinator (Acting), Reo
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REASON: 1.4 (b), (d)

¶1. (C) INTRODUCTION AND SUMMARY. Sarkis Aghajan Mamendu, Deputy Prime Minister and Finance Minister for the Kurdistan Regional Government in Erbil, told RC February 28 that the two KRG finance ministries would have a unified KRG budget by the end of 2006. The KRG would not fire any employees in the unification: surplus employees would go to newly created ministries. The KRG-E wished the region had a refinery. The KRG-E was trying to get other oil companies to become active in the Kurdish region. Iraq's MoO had been involved from the start in the KRG's contract with the Norwegian firm DPO; the MoO had not complained. The KRG-E collected customs on items as set by the GOI. The Baghdad MOF credited those amounts against what Baghdad owed the KRG-E. Iran tried to keep cross border trade small. It worried about the effect in Iran of Iraq's free markets and of alcohol smuggling. The KRG-E did not allow vehicles to enter from Iran. People had to cross on foot. The KRG-E vetted with the Asayish persons wanting to cross the border. END INTRODUCTION AND SUMMARY.

¶2. (C) On the unification of the KRG's in Erbil (dominated by the Kurdistan Democratic Party) and in Sulaymaniyah (dominated by the Patriotic Union of Kurdistan), Memendu said:

-- The two finance ministries would present and have a unified budget in time for the new fiscal year, which begins with the new calendar year. Budget preparation would begin in October.

-- The KRG would not fire any employees in the unification. Most of the finance ministries' staff were in the field, so could keep their jobs. (NOTE: The two KRG's do not overlap geographically. END NOTE.) They would transfer surplus employees to newly created ministries.

-- The budget would be transparent between all parts of the KRG, reducing possibilities for corruption in the unified government.

¶3. (C) On energy and fuel shortages, Memendu said:

-- Security problems created fuel problems: refineries either were not working or were a terrorist target.

-- Whenever the Iraqi government failed to pay Turkey for fuel and Turkey stopped selling fuel, it was Kurdistan that suffered.

-- Similarly, when the electrical grid system was attacked, the Kurdish region suffered. Mosul and Dahuk depended on electricity purchased from Turkey. The rest of the region depended on hydroelectric power from Lake Dokan and Iskan, which went into the national grid. The KRG-E hoped to build a 450 megawatt power plant in Erbil.

-- If the Kurdish region had a refinery, it would help both the region and the rest of Iraq. (KDP Politburo Secretary Fadil Mirani also touted this with RC the same day.)

-- Increased government fuel prices helped reduce smuggling out of the region to higher price areas and helped boost government revenues.

-- KRG-E conversations with other oil companies about activity in the Kurdish region were not yet at the MOU or agreement stage. (Read: Talks are going on.) Iraq's MoO had been involved from the start in the contract with the Norwegian firm DPO; the contract had not come as a surprise to MoO. The KRG-E had obeyed the constitution; statements by others had not matched the constitution. The KRG-E had gotten no official complaint from MoO.

14. (C) On customs revenues, Memendu said:

-- The KRG-E collected customs on items as set by the GOI.

-- "Iraq is all one treasury." Before the budget year, Baghdad asked for the projected customs revenues. At the end of the budget year, the KRG provided the actual revenue figures to Baghdad.

-- The KRG-E put in separate accounts the customs revenues it collected. The Baghdad MOF credited those amounts against what Baghdad owed the KRG-E.

-- Customs revenues were the KRG-E's largest revenue source,

KIRKUK 00000051 002.2 OF 002

but were much smaller than the subsidies Baghdad owed to the KRG-E. The KRG-E collected between \$1 and \$2 million per month; sometimes it reached \$2.5 million. Over the last several months, KRG customs had averaged \$1.2-1.3 million per month.

15. (SBU) On the state of the KRG-E's economy, Memendu said:

-- Living standards, investment and prices were all rising.

-- The industrial sector was weak; factories were few and old.

-- Agricultural was doing better than industry, but was not what it should have been. The Oil-for-Food program had destroyed Iraqi agriculture.

-- High prices forced the middle class, including civil servants, to moonlight, but the expanded private sector would produce more jobs than government subsidies would.

-- Workers were coming to the Kurdish region because the security situation was better than in the south, and because the economy was better. People in the north had already had 13-14 years to get used to a free market economy.

16. (C) In a separate conversation PUK Politburo Secretary Fadil Mirani complained that PM Ja'afari was still holding back \$100 million of the \$125 million promised to the KRG from the national budget. Part of this was he was calculating the revenues to share as if oil were at \$25 per barrel.

17. (C) On trade with Iran, Mememdu said:

-- The KRG-E had only one official border crossing with Iran: at Hajj 'Umrani. Other points were "not official." The KRG-E was seriously trying to control the border.

-- Hajj 'Umran had a market for cross border items: largely fruit and plastic goods. Iran tried to keep trade small. It worried about the effect in Iran of Iraq's free markets and of alcohol smuggling.

-- The KRG-E did not allow vehicles to enter from Iran. People had to cross on foot.

-- The KRG-E vetted with the Asayish persons wanting to cross the border. They were given a visa for a set time and purpose. Most people crossed in order to visit relatives (intermarriages had come from Iraqi Kurds' 25 years in Iran), to get medical treatment, or to trade.

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